IAS 12: Income Taxes and Certain Trust Structures

Extract, IFRS Discussion Group Report on Meeting – March 4, 2010

IAS 12 *Income Taxes* contains no equivalent to EIC-107, Application of CICA 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts. EIC-107 addresses the treatment of tax benefits received as a result of a distribution from a trust. If particular conditions are met, EIC-107 allows the trust to avoid recording current taxes because the entity has in effect an exemption from taxation. Secondly, EIC-107 provides guidance on whether any deferred taxes should be recorded. The members were asked to consider two views of the application of IAS 12 to the trust situation addressed in EIC-107. IAS 12 recognizes that some jurisdictions may have different tax rates depending on whether part or all of the net profit or retained earnings are distributed. Guidance on whether taxes should be recognized on temporary differences and whether the taxes are recorded in net income, other comprehensive income or equity are currently provided in paragraphs 52B and 61A of IAS 12. Specific commentary around the trust situation was also provided in the Basis for Conclusions (paragraphs BC80-81) of the Exposure Draft on Income Taxes published by the IASB in 2009.

The first view, View A, proposes that the Canadian trust situation is not one of an undistributed tax rate versus a distributed tax rate, as discussed in paragraph 52A of IAS 12. Proponents of this view believe that paragraph 52B of IAS 12 would be more pertinent to this issue, as it considers the distributions to be related to the past event of earning income. From this presumption they conclude that because the future distributions of the income earned will offset the tax obligation of the income earned, an entity would be, in substance, exempt from tax and no tax amounts would be recognized.

Proponents of View B, think that the tax implications of Canadian trusts would not create an exemption from the application of IAS 12. They think that the trust situation is the economic equivalent of two tax rates, an undistributed rate and a distributed rate, requiring paragraph 52A of IAS 12 to be applied. Therefore, the trust would be required to record current and deferred income taxes under IAS 12 because IFRSs do not allow the recording of a future expected distributions until the distribution is declared.

The members discussed the alternative views. The members were reluctant to recommend a communication to the IASB supporting the inclusion of the commentary in the Basis for Conclusions in the Exposure Draft of revisions of IAS 12, because more discussion was needed to clarify whether the issue relates to these trust situations being tax exempt or a two-rate system. The members agreed to revisit the issue at the IDG's June meeting.

Subsequently, the revised scope of the IASB project on Income Tax was discussed by the IASB at its March 2010 meeting. The AcSB staff advised the IASB staff of the discussions by the members of the IFRS Discussion Group. The IASB staff indicated that it would explore the possibility of resolving the issue of the tax effect of dividends by entities, such as real estate investment trusts and co-operative societies, in its short-term project to revise IAS 12.